FILE COPY No. 234

FILED
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CHARLES ELMORE

IN THE

Supreme Court of the United States

October Term, 1932

THE UNITED STATES OF AMERICA,
Petitioner,

against

HENRY PRENTISS & COMPANY, Inc.

AFFIDAVIT ON BEHALF OF PRENTISS & CO. SUBMITTED IN CONNECTION WITH BRIEF IN OPPOSITION TO PETITION OF UNITED STATES FOR WRIT OF CERTIORARI.

IN THE

Supreme Court of the United States

October Term, 1932

No. 234

THE UNITED STATES OF AMERICA, *Petitioner,*

v.

HENRY PRENTISS & COMPANY, INC.

STATE OF NEW YORK, }
COUNTY OF NEW YORK, } ss.:

JOSEPH F. MURRAY, being duly sworn, deposes and says:

I am counsel for Henry Prentiss & Company, and was such counsel upon the trial of this action and upon the appeal to the Circuit Court of Appeals.

After the determination of this case by the Circuit Court of Appeals Mr. Leon E. Spencer, the Assistant District Attorney who had tried this case and had handled the appeal to the Circuit Court of Appeals on behalf of the government, requested that we stipulate that issuance of the mandate be stayed for ninety days so as to give the government an opportunity to decide whether it wished to apply for a writ of certiorari. I told Mr. Spencer that if the government decided to apply for a writ of certiorari naturally we would desire to apply for a writ on behalf of Prentiss & Company. I stated that if the government did decide to apply for a writ I wished to be advised of that determina-

tion in advance of the expiration of the time for the filing of a petition so that I might arrange to file a petition on behalf of Prentiss & Company. The reason for the request was that each of the parties had been appellant in the Circuit Court of Appeals and that court had reversed the lower court in every respect. Prentiss & Co. was willing to have the matter rest where it was after the determination of the Circuit Court of Appeals, but in the event the case did go to the Supreme Court we did not wish to be precluded from advancing the errors which we claim the Circuit Court of Appeals committed as to Prentiss & Company.

Mr. Spencer told me that I would be so advised in the event that we signed the stipulation before mentioned. With that understanding, we did sign a stipulation staying the issuance of the mandate for ninety days and further staying the issuance until the disposition of a petition for a writ of certiorari if such a Petition should be filed. An order was entered upon that stipulation, copy of the stipulation and order being herewith attached and marked A.

The last day upon which a petition for a writ of certiorari could have been filed was July 18th, and I am informed that on that last day a petition for a writ of certiorari was filed on behalf of the government without having given to me or to the attorneys of record for Prentiss & Company advice that such a petition was to be filed.

By failure upon the part of the government to comply with the oral understanding which was had between the attorney for the government and myself, Prentiss & Company lost its right to apply for a writ of certiorari on its behalf. That it is a serious matter may be readily seen from the statement which I shall now present regarding the issues involved in this action.

The action was instituted to recover income and excess profits taxes claimed to have been illegally assessed for the

years 1918 and 1920. The taxes for these years were assessed under the Revenue Act of 1918. The plaintiff claimed that under the provisions of Section 326 of that Act it was entitled for each of the years in question to an invested capital in excess of the amount allowed by the Commissioner of Internal Revenue. Two items of property were involved in the claim; first, real estate and secondly, intangibles such as good will, contracts, etc.

There was and is no dispute between the parties as to the valuation of the properties in question and the case turned solely upon the construction of the provisions of the Revenue Act.

As to the real estate, the government admitted that under the provisions of the Revenue Act of 1918 plaintiff was entitled to additional invested capital but as to the year 1918 plaintiff was not entitled to recover for the overpayment because the refund claim was not sufficient in form to warrant a recovery. As to the year 1920, the government admitted that the plaintiff was entitled to additional invested capital for real estate.

As to intangibles, the government, admitting the existence and value of the intangibles, claimed that under the law and the facts plaintiff was not entitled to have intangibles included as part of invested capital and further contended that even if plaintiff was entitled to such inclusion under the 1918 Act it could not secure refund for the year 1918 on account of the insufficiency of the refund claim for such year.

After a trial before Judge CAFFEY, the latter held that under the Revenue Act of 1918 the intangibles should have been included as part of invested capital but because of the insufficiency of the refund claim for 1918 the plaintiff was not entitled to recover for either the intangibles or the

real estate. As to the year 1920, Judge CAFFEY decided that the plaintiff was entitled to increased invested capital for both the intangibles and the real estate.

Both parties appealed to the Circuit Court of Appeals, the plaintiff claiming that the refund claim for 1918 was sufficient and that it was entitled to increased invested capital for that year by reason thereof, the defendant claiming that Judge CAFFEY erred in allowing increased invested capital for the year 1920 for intangibles upon the ground that Section 326 of the Revenue Act of 1918 did not permit the inclusion of intangibles in invested capital under the facts disclosed.

The Circuit Court of Appeals reversed Judge CAFFEY in every respect except as to the inclusion of the real estate in invested capital for the year 1920. That Court held that the refund claim for 1918 was sufficient but that Section 326 of the Revenue Act of 1918 did not permit the inclusion of intangibles in invested capital under the facts disclosed. It, therefore, allowed the inclusion of real estate in invested capital for the year 1918 which Judge CAFFEY had disallowed. As to the year 1920, the Circuit Court of Appeals reversed Judge CAFFEY's ruling as to intangibles and held that under Section 326 of the Revenue Act of 1918 intangibles could not be included in invested capital for that year under the facts disclosed.

The result was that two courts had arrived at diametrically opposite views on the contested issues. In whatever respect the plaintiff prevailed before Judge CAFFEY it lost in the Circuit Court of Appeals, and in whatever respect the defendant prevailed before Judge CAFFEY it in turn lost before the Circuit of Appeals.

We claim that the Circuit Court of Appeals was in error in holding that under the facts intangibles should not

be included in invested capital for either of the years 1918 or 1920. The facts which we claim entitled the plaintiff to increased invested capital because of intangibles are as follows:

Plaintiff was organized in August, 1916, with a capital of $10,000 (R., 18). The purpose of the organization was to take over the business, property and assets of Prentiss Tool & Supply Company, a corporation organized in 1878, and which had during the intervening years been carrying on the business of buying and selling machine tools (R., 18, 19, 45-49). On August 17, 1916, plaintiff acquired from Prentiss Tool & Supply Company 100 shares of Atchison, Topeka & Santa Fe stock, at that time owned by the latter company, and issued in payment therefor all of its own capital stock (R., 18, 45, 46). The stock so acquired had an actual value of $10,000, was carried on the books of Prentiss Tool & Supply Company in the sum of $10,000 and was entered on the books of plaintiff at the same sum (R., 18).

Immediately thereafter the capital stock of plaintiff was increased to $500,000 (R., 54). Thereupon arrangements were made between plaintiff and Prentiss Tool & Supply Company whereby the latter was to sell to plaintiff and plaintiff was to acquire all of the "business, property and assets, real and personal, of Prentiss Tool & Supply Company, *including name, good will, contracts and rights of every character and description*", subject, however, to the debts and obligations of that company (R., 46-49).

The arrangement provided that plaintiff was to issue 4900 shares of its capital stock of the par value of $490,000 in payment for the property so to be acquired (R., 46).

The arrangement for such sale and acquisition is set forth in and authorized by resolutions adopted at meetings of stockholders and directors of both companies held

August 17, 1916, and August 26, 1916. Copies of the resolutions are annexed to the stipulation of facts entered into between the parties herein (R., 45-52) and were also attached to the brief filed with the Commissioner of Internal Revenue dated April 8, 1926, being Exhibit No. 12, not printed in accordance with stipulation and order omitting exhibits (R., 122).

The sale was effected, the properties were acquired by plaintiff, the stock was issued therefor, and the transaction was in all respects performed and carried out as set forth in the resolutions above referred to.

The property so acquired by plaintiff for $490,000 par value of its stock consisted of cash, accounts receivable, securities, inventories, fixed assets and intangibles.

There was no entry on the books of the Prentiss Tool & Supply Company covering intangibles or the value thereof. It is stipulated, however, that the Prentiss Tool & Supply Company owned intangible properties which were included in the transfer and that plaintiff acquired such intangibles and that the value thereof was at least $300,000 (R., 43).

Plaintiff in opening its books entered the property and assets acquired at the same value and in the same manner as theretofore carried on the books of Prentiss Tool & Supply Company, and the opening balance sheet of plaintiff was the same as the closing balance sheet of Prentiss Tool & Supply Company, except for necessary changes in surplus and capital, the normal incident of the higher capital of plaintiff. Plaintiff did not make any entry or show on its books any item for intangibles or the values existing therein.

Section 326 (a) of the Revenue Act of 1918 (40 Stat. 1092) provides:

> "(a) That as used in this title the term 'invested capital' for any year means * * *:

> (4) Intangible property bona fide paid in for stock or shares prior to March 3, 1917, in an amount not exceeding (a) the actual cash value of such property at the time paid in, (b) the par value of the stock or shares issued therefor, or (c) in the aggregate 25 per centum of the par value of the total stock or shares of the corporation outstanding on March 3, 1917, whichever is lowest; * * *"

Section 325 (a) of the Act provides that good will, franchises and other like property are included within the term intangible property.

The Circuit Court of Appeals based its decision against the plaintiff upon the ground that there should have been a specific issue of stock for intangibles, that Court saying (*Prentiss* v. *United States*, 57 F. (2d) 676, 678):

> "It is apparent that to include good will as invested capital the stock of the company must be specifically issued for the intangibles. It is not enough to issue it for the property generally which was taken over."

This holding is directly contrary to the ruling which the Board of Tax Appeals has consistently applied beginning with the case of *St. Louis Screw Company*, 2 B. T. A. 649.

See *Appeal of Mandel Bros.*, 4 B. T. A. 341;
Tyler & Hippach, Inc., 6 B. T. A. 636;
Penn. Cent. Brewing Co., 9 B. T. A. 264;
D. N. & E. Walter & Co., Inc., 10 B. T. A. 620.

The Commissioner of Internal Revenue specifically acquiesced in the decision of the Board of Tax Appeals in the *St. Louis Screw Company* case on page 28 of Cumulative Bulletin VII-1 containing rulings for January to June, 1928.

In *Lafayette-Southside Bank* v. *Commissioner*, 33 F. (2d) 646, 648, the Board of Tax Appeals had refused to include good will in invested capital on the amalgamation of two banks. The Court of Appeals of the District of Columbia affirmed that decision because of the fact that the parties expressly stipulated in their contract that no value should be placed upon the good will of the old banks and no stock was actually issued therefor. We believe that had there been in that case, as here, a provision that stock should be issued for a mixed aggregate of tangibles and intangibles, the Board of Tax Appeals and the Court of Appeals of the District of Columbia would have followed the ruling in the *St. Louis Screw Company* case.

In this case Judge CAFFEY specifically found as facts that the plaintiff purchased a mixed aggregate of tangibles and intangibles and that that property was bona fide paid in to plaintiff for stock of the plaintiff; and that a certain proportion of the shares of the stock was issued for the intangible properties (R., 73, 74).

The ruling of the Circuit Court of Appeals nullifies Section 326, subdivision (4), in every case where the value of the tangible property is in excess of the par value of the stock issued. If there had been an intention on the part of Congress to exclude such a case from the operation of the law, it would in our opinion have used more apt language to carry out its intent.

We have been unable to find any case which disagrees with the determination in the *St. Louis Screw Company* case except the determination in the instant case in the Circuit Court of Appeals.

The cases relied upon by the Circuit Court of Appeals in this case are entirely unlike the instant case.

The case of *LaBelle Iron Works* v. *U. S.*, 256 U. S. 377, deals with the question of the right to capitalize an increase in the value of property as earned surplus. It does not deal with a case where there has been the acquisition by purchase of property for shares in a corporation, and, therefore, Section 326 (a) is not applicable.

In *Crossett* v. *U. S.*, 50 F. (2d) 292, the Court of Claims specifically stated in its opinion:

> "It was agreed that of said property acquired, sufficient was to be taken at book value to pay at par for said stock, and the balance was to constitute a surplus at the organization of the corporation."

In other words, the *Crossett* case is exactly similar to the case of *Lafayette-Southside Bank* v. *Commissioner* (*supra*) because it was specifically agreed that the stock was paid for with the tangibles and not with intangibles.

In *Landesman* v. *Commissioner*, 44 F. (2d) 521, there was a definite finding that all the stock was issued for tangibles and no stock was issued for intangibles. The Court did state that no doubt good will existed and was acquired by the corporation and was in that sense probably an element affecting consideration paid for the property acquired. It was pointed out, however, that no stock was issued for the intangibles. In the present case there is an express finding amply supported by the evidence that stock was issued for intangibles. From the records of the *Landesman* case as it appears in 15 B. T. A. 64-66, it appears that the resolutions under which the stock was issued provided that all of the stock should be issued for specific tangible properties. In the instant case the resolution was that the stock should be issued for tangibles and intangibles and there is a finding of fact that stock was issued for good will. The Board of Tax Appeals in the

Landesman case neither enlarged upon nor overruled its prior decision in the *St. Louis Screw Company* case which has been consistently followed by the Board of Tax Appeals. The Board of Tax Appeals in the *Landesman* case disposed of the case upon the ground that the existence of good will had not been established.

Sufficient has been said to indicate that if the Circuit Court of Appeals was not absolutely wrong in its determination of the question of the inclusion of intangibles in invested capital, at any rate there is a very debatable question involved which the plaintiff would not intentionally waive if the case were to be submitted to this Court.

Under the judgment of the Circuit Court of Appeals the plaintiff here would have recovered practically the same amount as it would have recovered under the judgment based upon Judge CAFFEY's decision, and for that reason the plaintiff did not intend to seek a review of the ruling of the Circuit Court of Appeals unless the government sought a review.

If the government had given me as little as two days notice of its intention to apply for a writ I could have sought and no doubt obtained from a justice of this court a short extension of time within which to apply on behalf of Prentiss & Company.

If there had not been the oral understanding between myself and the attorney representing the government that I would be advised of the determination of the government to apply for a writ, I would have been diligent to see that the statutory period had not run against me.

JOSEPH F. MURRAY.

Sworn to before me this
26th day of August, 1932.

MABEL E. PALMER
Commissioner of Deeds, New York City.

A.

UNITED STATES CIRCUIT COURT OF APPEALS,

FOR THE SECOND CIRCUIT.

HENRY PRENTISS & COMPANY, INC.,
Plaintiff-Appellant and Appellee,

against

THE UNITED STATES OF AMERICA,
Defendant-Appellant and Appellee.

Upon the within consent of Jeffery & Redmond, Esqs., attorneys for the plaintiff-appellant herein, and upon all the proceedings heretofore had, it is, on motion of George Z. Medalie, United States Attorney for the Southern District of New York, attorney for defendant-appellant,

ORDERED that the issuance of the mandate in the above entitled case be and the same hereby is stayed for a period of ninety days from the date of this order, and it is

FURTHER ORDERED that if a petition for a writ of certiorari be filed in the Supreme Court of the United States within said period, the issuance of the mandate of this Court herein be stayed until the disposition of said petition.

Dated: New York, N. Y., April 25, 1932.

MANTON,
U. S. C. J.

Above order consented to:

JEFFERY & REDMOND,
Attorneys for Plaintiff-Appellant.